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An Examination of Accounting Principles and Standards for Federal Agencies (Title II)

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DIVISION OF FINANCIAL AND
GENERAL MANAGEMENT STUDIES

The Budget and Accounting Procedures Act of 1950 requires the General Accounting Office (GAO) to take the initiative in establishing accounting principles and standards applicable in the Federal Government. In light of the many recent advances in accounting theory and practice and a continuing effort to improve financial management, GAO has recently begun an effort to reexamine the Federal sector's accounting and financial reporting standards. The first step in this effort is to establish a foundation upon which current practices could be evaluated and upon which standards could be established and maintained. This foundation is called a conceptual framework. GAO has issued two exposure drafts in the conceptual framework. The first draft sets forth the objectives toward which accounting and financial reporting is directed and the second draft defines financial reporting elements.

However, before the conceptual framework project was begun, a considerable amount of research was done on the current standards and practices as contained in Title II of the "GAO Policy and Procedures Manual for Guidance of Federal Agencies." This provided insight into the reasons for establishing current requirements, clarified the scope of GAO's responsibilities, and allowed us to classify the current requirements into a structure of accounting emphasizing the theoretical and the practical. More importantly, once the structure of accounting in the Federal Government was established, this research provided an approach to complete the conceptual framework.

This statement summarizes the research performed on the current standards and practices. It is divided into four major sections: (1) the background of Title II, (2) the basis for Title II requirements, (3) the structure of Title II, and (4) the recommendations for establishing a conceptual framework. The background of Title II discusses those factors which played a significant role in the development of Title II requirements. It begins by discussing the environmental factors in the Federal Government which influenced Title II and then covers events occurring before 1940 such as the methods used by GAO to discharge its responsibilties which also influenced the shaping of Title II. Also discussed are the numerous laws and other events occurring after 1945 which provided much of the support for the requirements in Title II.

The next major section, the basis for Title II requirements, discusses an identification of 238 requirements and shows the number of requirements that resulted from a congressional law, a generally accepted accounting principle, a GAO-initiated requirement, or an executive agency requirement. The third major section analyzes the structure and presentation of Title II and organizes the requirements into four major groupings: those related to the objectives of accounting, those describing basic concepts underlying accounting practice, those setting forth reporting requirements, and those setting forth procedural requirements and internal controls. The last section, covering recommendations, sets forth an approach to developing a conceptual framework based on the findings in the previous sections and also identifies numerous issues and subjects to be researched and considered in the conceptual framework.

Although this statement is issued subsequent to the first two exposure drafts in the conceptual framework previously mentioned, the research summarized in it preceded our efforts on the framework. However, this statement brings out many interesting developments in Federal financial accounting and reporting and as such is intended to provide the background to our conceptual framework project. This document is issued for informational purposes to Federal agencies, to members of the accounting profession and the academic community, and to other interested persons in the financial community.

Sincerely yours,

D. L. Scantlebury
Director

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ABBREVIATIONS

GAO	General Accounting Office
JAIP	Joint Accounting Improvement Program
JFMIP	Joint Financial Management Improvement Program
GAAP	Generally Accepted Accounting Principles

INTRODUCTION

Current accounting principles, standards, and requirements1/ of the Comptroller General pertaining to the Federal Government are predominantly contained in title II of the "General Accounting Office Policy and Procedures Manual for Guidance of Federal Agencies." Title II requirements were originally issued in manual form in 1957, and since then they have been significantly revised to meet the changing needs of financial information users and the changing times.

Although title II standards have been the cornerstone toward improving accounting in the Federal sector and are still considered formidable, like most accounting standards they have not had a solid conceptual background to assure consistency. Up to now, changes in title II have been made in response to specific needs or events, and most of them have been made in individual requirements. Even the most noticeable change, which was made during the mid-1960s, resulted primarily from one event, widespread use of the computer. At that time, title II was summarized into booklet form, which eventually replaced the detailed 1957 manual.

1/ The terms "accounting principles," "accounting standards," and "accounting requirements" relating to title II are used interchangeably in this paper, and no attempt is made to define them.

In recent years, the state of the art of accounting and financial reporting has advanced to the point where accountants not only recognize the need to examine the structure of accounting principles, but also the need to establish a sound and consistent foundation for developing them. After this foundation is established, existing principles will be examined for consistency with it.

Recognizing the need to improve accounting in the Federal sector and considering the current state of the art, we have recently begun to reexamine title II requirements. Our approach, however, is broad based as are current efforts of the private and State and local government sectors. We have started at the bottom with a fresh look at accounting. Our overall goal is improved financial reporting, which we believe will lead to better financial management in the Federal Government.

METHODOLOGY

The first step in improving accounting in the Federal sector is to establish an acceptable foundation for developing accounting requirements. To be acceptable, however, the foundation must be comprehensive, cohesive, and consistent and must reflect past and current thinking on accounting. We first had to examine the current title II requirements and determine:

1. The background of title II--the environment in which the Federal Government operated, the situation during the early years of GAO's existence, and the state of the art of accounting.

2. The bases for title II requirements--specific events, laws, situations, or needs.

3. The structure of title II--organization of theories, concepts, reporting requirements, and procedures.

We also identified the constraints and other considerations that must be dealt with in establishing an acceptable foundation. In addition, areas in title II needing improvements were identified. Examples include identification of requirements needing clarifications and areas where title II is silent and requirements are needed.

This paper, therefore, summarizes the major findings of our examination of title II and shows how to establish a foundation for developing accounting principles in the Federal Government.

SCOPE

First we reviewed numerous GAO pronouncements, letters, files, and papers (including accounting principles memorandums) preceding the 1957 version of title II. Also, some books, articles, and other publications, including, but not limited to, Frederick Mosher's book on the history of GAO and articles from the "Federal Accountant" (forerunner of the "Government Accountants Journal," were analyzed.

The next step was very detailed. It involved listing the requirements in title II and for each one identifying its:

1. Basis--whether it was a law, one of the generally accepted accounting principles (GAAP), or a GAO or an executive agency requirement.

2. Purpose--what it was to achieve, for example full disclosure in reporting or control and accountability.

Finally, the various draft revisions of title II after 1957 were examined along with related GAO staff comments, memorandums, and correspondence. Information was also obtained from GAO staff who had firsthand knowledge of the many changes in title II over the years.

Some of the sources reviewed reflect situations existing before World War II. Surprisingly, these situations provided much of the background of the current title II. However, most of the events now which title II requirements are based occurred just before and after 1950, although numerous events which occurred after the late 1950s affected many requirements. Figure 1, page 31, summarizes the background and bases of title II requirements.

BACKGROUND OF TITLE II

Much of the background of the current title II can be traced to three items, the environment in which the Federal Government operates, events preceding 1940, and events occurring after 1945. The environmental factors played a significant role in the development of title II as did the events preceding 1940, which covered GAO's initial responsibilities and the difficulties encountered in discharging them in GAO's early years. Few significant events affecting title II occurred between 1940 and 1945 because of

World War II. However, the significant events occurring after the war resulted in inevitable changes which provided most of the background of title II. Each of these items is discussed separately below.

Environmental factors in Government

The environment in which the Federal Government operates is similar in many ways to that in which businesses operate. However, differences in the environments have caused the Federal Government and private sectors to emphasize different accounting factors in developing accounting requirements. Perhaps the most noticeable difference is the means for imposing regulation and control.

In the private sector, the operations of an entity are regulated and controlled by the profit incentive. To earn a profit, a business must continuously provide goods and services which consumers want. Consumers provide a built-in control by purchasing needed goods and services and by continuously investing capital in firms that are most profitable. Firms which are unresponsive to the public's needs and that operate inefficiently or uneconomically eventually will be forced out of business.

In the Government, a built-in profit motive does not exist. There is no open market to test the value of the Government's output; there is a remote and an indirect relationship, if any, between the recipient of goods and services provided and the resource provider (the Government); and the Government can force recipients to pay for services. Without alternative controls, there are no objective assurances that the Government will operate efficiently, effectively, and economically. The Government is, therefore, subject to more stringent legal and regulatory controls than are businesses, and accounting and reporting for the Government have evolved with a distinctive control emphasis.

In the early years, accounting in the Federal Government centered mainly around the internal workings of "accounting systems" and verification of legal and regulatory compliance. Accounting regulations and customs that had developed by the early 1930s primarily emphasized the control aspect and the legality of cash transactions and annual appropriations. Records relating to proprietary accounts were kept strictly on the cash basis.

Events preceding 1940

Another significant item leading up to the organization of title II and the type of requirements in it was the nature of the responsibilities initially assigned to GAO and the early methods GAO used to discharge them. Before 1921, the Treasury Department was responsible for approving expenditures and disbursements, settling accounts and claims relating to the Government, and establishing accounting and reporting requirements.

The Budget and Accounting Act of 1921 created GAO and the Bureau of the Budget (later established as a major office of the executive branch and subsequently changed in name to the Office of Management and Budget (OMB)) as a major division of the Treasury Department. GAO's primary responsibilities included:

1. All matters concerning receipt, disbursement, and application of public funds.
2. Rendering advance decisions on the legality of proposed expenditures.
3. Settling and adjusting all claims by or against the Government.
4. Prescribing accounting forms, systems, and procedures necessary to carry out its repsonsibilities.

The Budget Bureau was responsible primarily for preparing the budget for the executive branch for the President's submission to Congress. It also centralized budget preparation and monitored budget execution. Before 1921, expenditure proposals were presented to the Congress by each agency, and each was responsible for monitoring its own budget execution.

The early methods GAO used to discharge its responsibilities were very detailed. GAO settled all accounts of accountable officers, postmasters' accounts, and claims by or against the Government; monitored nearly all appropriations and other limitations; and countersigned all warrants and approved nearly all requisitions for disbursing funds. In essence, GAO examined some aspect of practically every transaction the Federal Government made. Because of its responsibilities, GAO, in reviewing transactions, focused on legality, appropriateness, and accuracy.

Unfortunately, in GAO's early years, cooperation between GAO and executive agencies on accounting matters was lacking. One source stated that the accounting benefits anticipated from the Budget and Accounting Act of 1921 were

> "* * * largly lost in jurisdictional disputes over matters of form and authority between the Treasury Department and the individual executive agencies and the Comptroller General. Accounting regulations of the Comptroller General were sometimes in conflict with regulations of the Treasury Department or were disregarded by the agencies as being ultra vires. Also, the emphasis of accounting regulations issued by * * * [both] * * * continued to be mainly concerned with legality of transactions rather than the development of accounting for management use."

Another source stated that the laws relating to GAO placed the Comptroller General in potential opposition with Treasury and the Budget Bureau. GAO accounting responsibilities were basically to assure compliance with law; Treasury's were to keep track of appropriations, expenditures, revenues, debt, and the financial condition of the Government; and the Budget Bureau's were to provide information for effective management and appropriation control. Since cooperation between the agencies could not be achieved, GAO built its own detailed accounts of receipts, expenditures, disbursements, and appropriations. Initially, the foundations of the agencies were the same: appropriations and warrants. However, beyond that similarity they were irreconciable.

The differences between GAO and the executive agencies on accounting matters continued, at times marked by specific controversy, until the late 1930s when one observer noted that decentralization and the lack of uniformity was so pervasive in Government that management had to rely on less formal devices. Administrators relied on "little black books" crammed with statistics about their agency's financial matters that bore little resemblance to what GAO or Treasury prescribed as official agency accounts. The predominant concern of administrators with regard to recordkeeping and financial reporting centered around compliance and the legality of obligations and cash transactions to cover their own operations rather than accounting for management use.

By the late 1930s, the state of the art of accounting in the Federal sector had lagged significantly behind the rapid changes in the sizes and types of Government activities and the advancements made in the private sector. Federal sector accounting was preoccupied with the detailed voucher examinations and other detailed verification. Accounting expertise in Government left much to be desired.

The inadequacies of Government accounting were one reason for the creation of many Government corporations during the mid-to-late 1930s. These corporations were usually exempt from the accounting regulations and customs concerning legality and compliance. Sometimes they were able to obtain the services of experts from the private sector, the most notable of which was Eric Kohler, and sometimes modern accounting systems set up on the accrual basis with an emphasis on assisting management resulted. Unfortunately, this advancement, as significant as it was, occurred only in isolated cases, and the Government generally continued to be bogged down in detailed verifications.

Events occurring after 1945

Just before World War II, a major change occurred that was necessary before any significant improvements in accounting could be made Government wide. A more cooperative atmosphere between GAO, Treasury, and the Budget Bureau resulted from the appointment of a new Comptroller General. However, because of the war, any immediate improvements were postponed until the late 1940s. In addition, improvements in Government accounting resulted from the influx of accounting expertise and the emphasis of auditing shifted from detailed verifications to a more comprehensive systems approach.

The situation facing GAO after the war which resulted in the influx of accounting expertise and a shift in auditing emphasis is interesting.

First, the detailed voucher check system was doomed simply by scale, if nothing else. In 1947 GAO:

--Kept about 414,000 accounts of appropriations, limitations, accountable officers, and others.

--Countersigned or approved about 74,000 warrants or requisitions for disbursing funds.

--Audited 93,000 accountable officers' accounts containing about 42 million vouchers or contracts and about 350 million postal transactions.

--Settled about one and one-half million accountable officers' or postmasters' accounts or claims.

--Reconciled almost one-half billion checks.

Second, the Government Corporation Control Act of 1945 placed an unusual responsibility on GAO. It required GAO to audit, but not settle, the accounts of Government corporations, as is done in commercial audits directed not exclusively at legal compliance. While this responsibility had been placed on GAO during the 1930s, it applied to only a limited number of corporations. However, now it applied to the more than 100 corporations existing in 1945.

These factors led to the growing expertise in accounting in GAO (by 1948, 54 certified public accountants worked for GAO compared with few, if any, before 1945) and the development of a comprehensive audit approach. The knowledge gained in the comprehensive approach also assisted in accounting reform from the detailed voucher examinations to an overall systems approach.

The new cooperative atmosphere encouraged the heads of GAO, Treasury, and the Budget Bureau toward a collaborative approach for improving accounting in the Federal Government. In late 1947, the heads of each agency agreed to a Joint Accounting Improvement Program (JAIP) whereby accounting reforms would be the joint product of the three agencies. JAIP was a unique effort for that time, since it was created without benefit of legislation. It was established by the heads of three agencies which, just a decade before, had been involved in jurisdictional disputes and controversy.

Recognizing the need for uniformity and centralized direction, JAIP in 1949 enumerated three main policies:

1. Government accounting processes would be consolidated and integrated for the benefit of the Government as a whole.

2. Since individual operating agencies are the points where improvements must be made, improvements must be directed toward effective controls and proper records at the agencies.

3. The responsibilities of GAO as an oversight agency would be prescribing accounting systems and making system inspections and comprehensive audits as opposed to keeping records otherwise kept by Treasury, Budget Bureau, or operating agencies.

The Budget and Accounting Act of 1950 gave formal congressional approval to the cooperation begun under the auspices of JAIP. JAIP later changed its name to the Joint Financial Improvement Program (JFMIP). The overall objective of JFMIP is to improve financial management and accounting in the Federal Government. Over the years JFMIP, in achieving this goal, has:

--Sponsored conferences, workshops, and seminars on accounting and financial management.

--Reviewed the management and accounting improvement efforts of operating agencies.

--Sponsored or conducted research.

--Published periodic bulletins and other documents on accounting and financial management.

Although JFMIP has contributed in many ways toward improving accounting and indirectly providing the bases for some title II requirements, the most significant contribution is the requirement for a joint effort which guards against unnecessary friction between GAO and the executive agencies. Accounting principles become effective and meaningful upon general acceptance. JFMIP provides the vehicle for input from the agencies. Accounting requirements, including those in title II, were officially promulgated only after review by executive agencies.

Another significant event occurring after 1945 was the creation of the Hoover Commissions. Prewar criticism and dissatisfaction in accounting in the executive branch played a part in prompting the Congress in 1947 to create the first

Hoover Commission. The Commission was to study the organizations of Government agencies, and it submitted its report to the Congress in 1949. The second Hoover Commission was created in 1953 to study policy questions relating to Government operations, and it reported to the Congress in 1955. Both Commissions made recommendations on accounting and budgeting.

Although various studies and reports on accounting in Government were issued before the Hoover Commissions' reports, the Commissions' reports and recommendations made perhaps the most significant contributions to improvements that were made. The first Commission recognized and approved JAIP and emphasized the need for uniformity in accounting, budgeting, and reorganizing accounting procedures and methods. Among its significant recommendations were:

- --Use of performance budgets which emphasize work to be done rather than objects to be bought.
- --Separation of current expenditures from capital outlays in agency budget estimates.
- --Establishment of a new Accountant General in the Treasury Department to provide central direction and uniformity in developing accounting systems.
- --Establishment of accrual accounting in Government to replace exclusive use of cash accounting in the proprietary accounts and to supplement appropriation accounting.

Among the significant recommendations of the second Commission were:

--The use of cost data by agencies in budget preparation and presentation to the Congress and budget execution.

--Synchronization of budget classifications and accounting systems among agencies.

--Centralization of the responsibility for guiding and supervising in the development of accounting systems of executive agencies in the Bureau of the Budget.

--Assignment of the responsibility for developing accounting principles binding upon executive agencies to GAO.

Although not every recommendation of the Commissions was incorporated into law, most relating to accounting and budgeting eventually were. For example, the Bureau was given the responsibility of providing central direction and uniformity in developing accounting systems and GAO was given the responsibility of reviewing and approving the systems in accordance with its own principles and standards.

BASES FOR TITLE II REQUIREMENTS

The concurrent efforts of the Hoover Commissions and JAIP, along with the increased expertise of accounting in the government, led the way to accounting improvements in the Federal Government beginning in the late 1940s. Most of the sweeping changes were made through legislation. Between 1949 and 1956, at least 10 major laws or amendments were enacted. Other improvements were made within GAO and the executive agencies, many of which were based on existing generally accepted accounting principles applicable to the private sector.

This discussion on the bases for title II requirements is divided into three parts--the 1957 version of title II, subsequent changes to title II, and an analysis of current title II requirements.

The 1957 title II

The postwar efforts resulted in significant financial and accounting legislation, the requirements of which directly affected the creation of title II.

The first law passed related to accounting and control over Federal property, a subject previously neglected. The Federal Property and Administrative Services Act of 1949 became law a few months after the first Hoover Commission report. The two most important mandates of the act were (1) the requirement of each executive agency to maintain adequate inventory controls and accountability systems for property and (2) the establishment of the General Services Administration.

The second law, also passed in 1949, contained amendments to the National Security Act of 1947. The major amendments, relating to accounting and budgeting, required monetary and quantity control to be maintained over property in the Department of Defense and authorized it to use performance budgets.

The next important law passed in 1950, was the Post Office Department Financial Control Act. Although it did not provide any specific basis for title II, it formally transferred accounting responsibility for the Department from GAO to the Post Office Department. The anomalous situation whereby GAO was keeping the Department's accounts, which had persisted since 1923, came to an end.

Unquestionably the most sweeping financial and accounting legislation of the period was the Budget and Accounting Procedures Act of 1950. The most significant sections were contained in title I, part II, which is sometimes cited as the Accounting and Auditing Act of 1950. Most of the provisions resulted from the efforts that JAIP, the Hoover Commissions, and which GAO had already begun a few years previously. Important provisions of the act which provided direct bases for title II included:

--Implementation, as soon as possible, of the accrual basis of accounting in executive agencies.

--Continuation of JAIP.

--Assignment of responsibility to GAO to help develop their accounting systems and to review and approve them.

--Accounting and reporting by Treasury with GAO principles.

--Implementation of budget preparation and presentation by functions and activities (performance budgeting).

Numerous other acts and amendments were passed by the Congress during the period ending before the 1957 version of title II. These acts and amendments either required certain accounting or budgeting recognition where none had previously existed or clarified requirements of previous laws. For example, the Public Building Purchase Contract Act of of 1954 provided for use of lease-purchase contracts previously nonexistent in Government operations and disclosure of such transactions in financial reports. An example of of a law which clarified previous legislative requirements appears in Public Law 84-863, approved in 1956. This law, which contained no title, was, in essence, an amendment to the Budget and Accounting Act of 1921 and the Budget and Accounting Procedures Act of 1950. The act of 1950 implied implementation of the accrual basis of accounting. However, the law of 1956, among other mandates, specified that each executive agency head shall cause the accounts to be kept on an accrual basis. Figure 2 lists all laws providing direct bases for title II requirements.

As a result of the revamping of accounting that was taking place in the Federal Government through passage of legislation, as well as GAO's new responsibilities, GAO began to publish accounting principles in memorandum form. The first one, entitled "Accounting Principles Memorandum No. 1," appeared in late 1952. It included all requirements applicable to accounting from the acts and amendments to the acts passed in 1949 and 1950. It also included as requirements certain current GAAP and related accounting and budgeting requirements of executive agencies.

At that time, GAAP consisted primarily of accounting research bulletins. About 40 bulletins had been issued. The private sector had been developing accounting principles over the preceding 40 years or so. These principles provided the conceptual and practical guidance in areas not otherwise covered in the laws or customs of Government accounting practice. As a result, the guidance provided by GAAP was a source of a number of the requirements in Memorandum No. 1.

In all, GAO issued three accounting principles memorandums; the last was issued in October 1957. Some sources for provisions in Memorandum No. 3 were Treasury and Budget Bureau circulars containing requirements applicable to executive agencies. These requirements enabled the Department and the Bureau to carry out their responsibilities of budget control and central reporting of the overall executive branch's financial condition. Because of the cooperative effort of JAIP, GAO included the requirements of Treasury and the Bureau in its principles. Later the provisions and recommendations of executive orders and reports of special commissions and studies of the President were included.

In late 1957, GAO consolidated its accounting principles memorandums into a manual form of title II. At that time, plans for the manual included much more than what was in the memorandums. The memorandums, ranging from a few pages to 30 pages, discussed requirements of laws, concepts in accounting, definitions, and general reporting requirements. Also, the plan included detailed accounting records (ledgers and journals), examples of journal entries, and standard documents and forms to be used in processing transactions. In addition, the plans included detailed descriptions of internal controls which were to become required in accounting systems approved by GAO.

Subsequent changes in title II

Many changes to the title II manual were made after 1957. Up to the mid-1960s, most changes were additions to the 1957 version based on the plans existing when the manual was originally issued. The changes continued to be based on the passage of new legislation, promulgation of new GAAP, and requirements issued by the Treasury and Budget Bureau. However, many changes relating to procedural matters and the "internal workings" of the accounting system, such as internal controls, resulted from GAO efforts. The bases for these changes lay in the environment in which the Government operates and the related responsibilities assigned to GAO. It is interesting to note that GAAP in the private sector concern financial reporting exclusively, whereas GAO principles have gone beyond financial reporting to include procedural aspects of systems design and operation. In the private sector, procedural aspects are left to management rather than standard-setting bodies.

Although the specific bases for the changes made in title II during the mid-1960s and 1970s continued to be the passage of legislation; new GAAP and efforts begun by GAO, Treasury, and the Bureau, the background of these changes is worth mentioning. The most notable item relates to advancing technology as evidenced by the widespread use of the computer. Before the mid-1960s, title II requirements delineated an entire set of accounts, journals, ledgers, standard forms, and journal entries. The old title II required, for example, subsidiary ledgers in a certain format to contain detailed data on property. The revisions to title II included only a general statement requiring significant classifications of property and other details to be kept in the accounting records rather than prescribing format.

Another feature of the changing times was the making of new types of agreements and transactions or the more frequent making of previously infrequent agreements and transactions. Examples include lease-purchase agreements in the late 1950s, more leasehold improvements to real property, and more foreign currency transactions. GAAP-setting bodies (the Accounting Principles Board and the Financial Accounting Standards Board) created in the private sector performed research and issued authoritative pronouncements on these newer, more frequent transactions and agreements, as well as other areas of concern, such as reporting changes in financial position. Based on GAAP and GAO's own initiative, changes in title II requirements included either more coverage in these areas or coverage where none had previously existed.

Another important feature of the changing times was the emerging of new programs and activities authorized by the Congress without related accounting mandates. In the mid-1960s, the Federal Government began large-scale grant and subsidy programs and increased the number of insurance and guarantee programs. Many title II requirements resulted from these programs. Examples of new title II requirements include specific requirements for reporting contingent liabilities common among guarantee and insurance programs. (These requirements first appeared in the most recent 1978 revision.) GAAP continued to provide guidance, for example, on reporting contingent liabilities. Treasury and the Office of Management and Budget (previously the Bureau of the Budget) also issued requirements, such as OMB Circular A-102, which discusses grant requirements applicable to State and local governments.

Analysis of current title II

First we identified each of the 238 title II requirements. A requirement was considered any statement in title II and its review guides for reviewing standards and systems design. To be a requirement, the statement had to contain a mandate, regardless of how general or specific it was, which executive agencies must carry out. Certain statements in title II did not qualify as requirements. Examples include section 3, which discusses separately published booklets containing illustrative accounting procedures, and section 27.2, which covers assistance provided by GAO to agencies in accounting systems design.

After identifying the 238 requirements, we determined the direct bases for their inclusion in title II. The specific bases for requirements, as previously brought out in this paper, are:

1. A congressional law or an amendment to a law.
2. One or more GAAP.
3. A GAO requirement.
4. A Treasury or OMB requirement, an Executive Order, or recommendations of reports from commissions or special studies of the President.

Some requirements had more than one basis, mainly because they were long statements with many provisions. Most of these requirements involved GAAP and GAO-imposed requirement. Determining whether the basis was a law, an executive branch requirment, or a report was usually straightforward. However, in distinguishing between GAAP and GAO-imposed requirements, GAAP were given priority.

The breakout of the bases for the requirements and their percentages follows.

Requirements		
Based on	Number	Percentage
Law	62	26
GAAP	81	34
GAO requirement	89	37
Executive agency requirement	6	3
	238	100

STRUCTURE OF CURRENT TITLE II

An examination of title II requirements would be incomplete without an analysis of their organization and presentation. The benefits of this analysis will provide substantial help in establishing a foundation for developing accounting standards. These benefits include identification of areas needing clarification or areas where title II is silent and requirements are needed. This analysis was done in conjunction with the detailed one discussed in the preceding section, which determined the specific basis for each requirement. But in this analysis, we determined the purpose each requirement serves.

Title II is currently divided into three chapters. The first deals mostly with general legislative responsibilities of GAO and JFMIP and standards for internal management control. The second chapter covers mainly concepts; legal and other requirements for recognition, reporting, and processing transactions under the categories of spending congressional authority, assets, liabilities, equities, revenues, and costs. The third chapter covers GAO's review and approval of agencies' accounting principles and systems designs.

Title II requirements cover broad areas of accounting and range from very general to very specific. General requirements cover such topics as the need for accounting to satisfy congressional needs or to produce useful financial information. Very specific requirements address detailed procedures, such as those relating to the handling of cash. Many general requirements are also conceptual or theoretical and cannot be implemented in practice without first developing the detailed means to implement them. Very specific requirements can be implemented in practice without delineating further requirements.

For example, section 8.2 states that accounting must produce financial information needed to keep the Congress fully informed of an agency's operations. While this requirement is essential, it is also general, and implementing it would necessitate developing numerous additional requirements, such as reporting formats for assets, liabilities, and appropriations, as well as specifying other nonfinancial statement data. On the other hand, section 12.5 (d) contains the minimum dollar criterion ($300) for capitalizing the cost of property purchased (as opposed to expensing the cost). This detailed item needs no further requirements for implementation.

The broad range of requirements of title II, from the general to the specific, are divided into two main divisions. The first division deals with theoretical and conceptual requirements and is general. The second deals with the practical aspects; the requirements in this division can be more readily implemented in practice without first developing further requirements. Each division, in turn, can be divided into two categories.

The theoretical division includes (1) objectives of accounting and (2) fundamental concepts. The practical division includes (1) reporting requirements and (2) procedural requirements. Figure 3, page 33, further explains the characteristics of each category.

Most of the 238 requirements are easily identified as theoretical or practical and can be readily grouped under the appropriate category. However, some requirements were not so conveniently grouped and required more judgment than had been hoped for. This occurred mainly because some requirements were long statements containing compound provisions. Requirements containing provisions falling under more than one category were grouped based on the following priority:

1. Reporting requirements.
2. Procedural requirements.
3. Accounting objectives.
4. Fundamental concepts.

The groupings of the 238 requirements and their percentages follow.

Category	Number	Percentage
Accounting objectives	24	10
Fundamental concepts	13	6
Total theoretical	37	16
Reporting requirements	117	49
Procedural requirements	84	35
Total Practical	201	84
Totals	238	100

Figure 4, page 35 shows both breakouts of title II requirements by basis and by organization. Figure 5, page 36, shows a matrix combining title II requirements by basis and by organization.

CONCLUSIONS AND RECOMMENDATIONS FOR ESTABLISHING A FOUNDATION

The examination of title II requirements, from identification of the background leading up to its formulation, to the analysis of its organization, provide ample support for the wide range of its provisions. The entire section 4, which concerns JFMIP, while not containing any of the 238 requirements, is nonetheless vital to creating cooperation in improving accounting in Federal Government. Without cooperation, improvements are likely to be rare exceptions, as the case during the 1930s.

However, refinement in accounting requirements, including those in title II, are necessary considering advancements recently made and still being made in the state of the art. The first step toward establishing a foundation for developing accounting requirements would be to identify the scope of accounting in the Federal Government. Our analysis of title II's organization provided this. We divided the requirements into two divisions, theoretical and practical. Each division, in turn, was divided into two categories. As the characteristics in each category indicate, the scope of accounting ranges from the very basic accounting objectives to detailed procedures encountered in everyday accounting operations.

The theoretical division, containing objectives and fundamental concepts, would logically form the foundation from which to develop accounting principles. However, the current title II should be restructured to make it clearer and more complete. It could be divided into the same four categories. A separate research effort could be devoted to each category, and this would allow for an in-depth analysis of the current state of the art and the needs of the Federal Government. Also, an effort devoted to each category would allow for greater input from all interested agencies and others rather than one sweeping revision at one time. Completion of a foundation and subsequent reevaluation of reporting and procedural requirements in steps, rather than all at once, would also facilitate acceptance by agencies upon completion. This was the case in the early 1950s, when the original title II was issued as a culmination of the numerous improvements made one at a time.

Separate research to be done by GAO would undoubtedly result in greater clarity and completeness of Federal Government accounting requirements.

During the research effort for the first category, accounting objectives, users of financial reports would be identified, their needs studied in depth, and objectives formulated based on these needs. Also, the environment in which the Federal sector operates could be studied in more detail in order to establish legal and other constraints within which accounting must operate.

The research effort for the fundamental concept category could resolve numerous issues and questions currently facing accounting in the Federal sector. For example, the researchers could, among other things:

-- Define and explain the elements of accounting (assets, liabilities, revenues, expenditures, obligations, expenses or costs, and equities) and identify the general criteria necessary to recognize elements of a transaction.

-- Discuss methods for measuring and valuing elements of transactions and determining what constitutes an accounting or a financial reporting entity in the Federal Government.

-- Study the longstanding concepts, such as accrual accounting, matching concept, time-period, objectivity, and going-concern, that surround accounting and determine where they fit into a conceptual framework and what purpose the serve.

When the research efforts for these two categories are completed, the conceptual framework will be complete and reporting and procedural requirements can be reevaluated. First, a complete distinction between reporting and procedural requirements must be made, and it must result in clearly defined boundaries separating each. Once this is done, the accounting requirements can be reevaluated and then finally placed in either the reporting or the procedural category. Efforts devoted for each category can then further refine the requirements. For the reporting category, GAO researchers can explain how reports showing operations, financial position, and resources can be improved. For the procedural category, separate efforts can be devoted to clarifying such questions as:

-- What are the boundaries between the procedural aspects of an accounting system and implementation?

-- What constitutes adequate documentation of an accounting system?

-- What specific controls should exist in a proper accounting systems design?

In conclusion, this paper has provided some insights into the background of title II as well as analyzed its bases and organization. While the background portion of the paper provided some items worthy of consideration in the next phase of work (a look at the environment of the Federal sector), the basis and organization portions provided most of the support for our recommendations. The next step is a research effort devoted to the objectives of accounting and financial reporting in Federal Government followed by research efforts devoted to the other categories.

Figure 1

Summary of the Background of and Bases for Title II

	Time				
	1978	Current title II Changing times			
Specific bases for title II	1957	First version of title II Accounting principles memorandums			
	1949-1950	Laws	GAAP	GAO requirements	Executive branch requirements
	1948	Hoover Commissions			JFMIP
Background of title II	1940-1945	Influx of accounting expertise	Cooperative atmosphere between GAO and executive branch	Comprehensive systems approach	
		Compliance-oriented accounting	Lack of unformity	Detailed voucher examination	
	1921	Responsibilities assigned to GAO			

Environmental factors of Federal Government

FIGURE 2

Laws Affecting Title II Requirements

1. Budget and Accounting Act of 1921
2. Economy Act of 1932
3. National Security Act of 1947 (amendments only)
4. Federal Property and Administrative Services Act of 1949
5. Budget and Accounting Procedures Act of 1950
6. Public Buildings Purchase Contract Act of 1954
7. Public Law 84-863 (no title) 1956
8. Foreign Assistance Act of 1961

In addition, numerous amendments to these and other laws have been passed by the Congress. These amendments appear in title 31 of the United States Code relating to financial requirements. The sections of title 31 where the numerous amendments appear are 18, 20, 24, 65, 66, 200, 628, 665, and 1400.

Figure 3

Four Types of Title II Requirements

P R A C T I C A L

PROCEDURAL: Accounting procedures which insure:

1. The control over resources.
2. The reporting of reliable financial information.

Characteristics include:

--The processing of transactions on source documents or forms.
--The recording of transactions in summary accounting records and the compiling of reports.
--The account and code structure.
--The maintenance of audit trails.

REPORTING: Rules for recognition of transactions for reporting and for reporting formats.

Characteristics include:

--Criteria for recognizing transactions.
--Criteria for measuring or valuing components of transactions.
--Criteria for allocating resources obtained or used.
--Rules for report format and disclosures.

T H E O R E T I C A L

FUNDAMENTAL CONCEPTS: Concepts and theories which form the basis for reporting and procedural criteria.

Characteristics include:

--Identification of the accounting entity.
--Definitions of liabilities, revenues, and costs.
--Definition of financial reporting.

Figure 3 (continued)

OBJECTIVES: Purposes to be achieved through accounting.

Characteristics include:

--Identification of users.
--Identification of information which satisfies users' needs.

Figure 4

Breakout of Title II Requirements by Basis and by Organization

Basis

Based on	Requirements: Number	Requirements: Percentage
Law	62	26
GAAP	81	34
GAO requirement	89	37
Executive agency requirement	6	3
Total	238	100

Organization

Type	Requirements: Number	Requirements: Percentage
Objectives	24	10
Fundamental concepts	13	6
Total theoretical	37	16
Reporting	117	49
Procedural	84	35
Total practical	201	84
Totals	238	100

Figure 5

Matrix of Title II Requirements by Basis and Organization

	Number of Requirements				
	LAW	GAAP	GAO requirements	Executive agency requirements	Total
Objectives	9	7	8	0	24
Fundamental concepts	4	5	2	2	13
Total theoretical	13	12	10	2	37
Reporting	30	50	34	3	117
Procedures	19	19	45	1	84
Total practical	49	69	79	4	201
Total	62	81	89	6	238